Supreme Court, U.S.
FILED
JUN 23 2003
OFFICE OF THE CLERK

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No. 03-2

In the

Supreme Court of the United States

OXFORD ASSET MANAGEMENT, LTD., and SUSMAN & WATKINS,

Petitioners,

v.

MICHAEL JAHARIS, DANIEL M. BELL, DUNCAN H. COCROFT, JUAN F. RODRIGUEZ, ROBERT E. BALDINI, JOHN BRADEMAS, STEVE JAHARIS, LOUIS LASAGNA, MARK NOVITCH, FREDERICK B. WHITTEMORE, KOS PHARMACEUTICALS, INC., COWEN & COMPANY, DONALDSON LUFKIN & JENRETTE, SALOMON SMITH BARNEY HOLDINGS, INC., SBC WARBURG, DILLON, READ, INC., individually and as representatives of THE CLASS OF UNDERWRITER DEFENDANTS,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Whether, notwithstanding the "notice pleading" standard set forth in Fed. R. Civ. P. 8(a), a heightened "fact pleading" standard applies to claims under §§ 11 and 12(a)(2) of the Securities Act of 1933, 15 U.S.C. §§ 77k and 77l(a)(2), even where those claims are based on strict liability and expressly disavow any reliance on fraud.

II. Whether, in an action under §§ 11 and 12(a)(2) of the 1933 Act, a court may determine as a matter of law that facts which the court acknowledges to be material to investors in a securities offering are nonetheless not subject to required disclosure in the securities offering documents.

III. Whether sanctions may be imposed against a §§ 11 and 12(a)(2) plaintiff, and its counsel, for failing to meet a heightened "fact pleading" standard that is not only incorrect as a matter of law, but also was applied for the first time in this case and is contrary to the law of other circuits.

LIST OF PARTIES

The Eleventh Circuit ruled in this case after consolidating Oxford's two appeals: (1) Oxford's appeal of the district court's dismissal of the complaint (No. 99-11690); and (2) Oxford's appeal of the district court's order sanctioning plaintiffs and their counsel (No. 00-13220). The parties to those proceedings were as follows:

No. 99-11690:

Oxford Asset Management, Ltd. was Plaintiff-Appellant.

Michael Jaharis, Daniel M. Bell, Duncan H. Cocroft, Juan F. Rodriguez, Robert E. Baldini, John Brademas, Steve Jaharis, Louis Lasagna, Mark Novitch, Frederick B. Wittemore, Kos Pharmaceuticals, Inc., Cowen & Company, Donaldson Lufkin & Jenrette, Salomon Smith Barney Holdings, Inc., SBC Warburg, Dillon, Read, Inc. were Defendants-Appellees.

No. 00-13220:

Oxford Asset Management, Ltd. and Lowey Dannenberg & Knapp, P.C. Profit-Sharing Plan, a/k/a Lowey Dannenberg, Bemporad & Selinger P.C. Profit-Sharing Plan were Plaintiffs-Appellants. Arthur T. Susman, Charles R. Watkins, Robert J. Emanuel, and Susman & Watkins were additional Appellants.

Defendants-Appellees were those named in No. 99-11690.

RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Petitioners state that Oxford Asset Management, Ltd. and Susman & Watkins have no parent corporations and that no publicly held corporation holds 10% or more of the stock in either Oxford Asset Management, Ltd. or Susman & Watkins.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Oxford Asset Management, Ltd. ("Oxford") and Susman & Watkins (the "Susman Firm") petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. 1-27) is reported at 297 F.3d 1182. The order of the court of appeals on denial of the petition for rehearing (App. 77-78) is unreported. The orders of the district court dismissing the complaint with prejudice (App. 28-60), granting the motion for sanctions (App. 61-73), and assessing fees (App. 74-76) are all unreported.[1]

JURISDICTION

The judgment of the court of appeals was entered on July 16, 2002. A timely petition for rehearing *en banc* was denied on March 25, 2003 (App. 77-78). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES AND RULES INVOLVED

Pursuant to Rule 14.1(f), citations to the statutes and rules relevant to this case are set out below. The full text for each appears in Appendix 79-123.

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[1] Unless otherwise indicated, all citations are to the attached Appendix ("App. __.") or to the Record originally filed with the court of appeals in this case ("R. __.").

- Sections 11, 12(a)(2), and 15 of the Securities Act of 1933, as amended, 15 U.S.C. § 77k, 77l(a)(2), and 77(o) (App. 79-87.)
- Sections 101(a) and 101(b) of Pub. L. 104-67, the Private Securities Litigation Reform Act (PSLRA), 15 U.S.C. §§ 77z-1, and 78u-4 (App. 88-118.)
- Rules 8(a)(2), 9(b) and 11 of the Federal Rules of Civil Procedure, Fed. R. Civ. P. 8(a)(2), 9(b), and 11 (App. 119-123.)

STATEMENT

The United States District Court for the Southern District of Florida dismissed with prejudice Oxford's complaint, which, among other things, sought relief under §§ 11 and 12(a)(2) of the Securities Act of 1933 against Kos Pharmaceuticals Inc. ("Kos") and others. The complaint alleged that Kos made several specific material misrepresentations and omissions in the prospectus and registration statement filed in connection with its October 1997 secondary offering of common stock (the "Secondary Offering"). The district court dismissed the complaint, finding that the allegations lacked sufficient factual particularity under a heightened pleading standard which it deemed applicable, and then sanctioned Oxford and its counsel over $520,000 for bringing the complaint. The Eleventh Circuit affirmed the dismissal of the complaint and the award of sanctions, virtually in its entirety.[2]

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[2] Sections 11 and 12(a)(2) of the Securities Act of 1933 provide a cause of action to purchasers of securities against the issuer or other seller where a registration statement (§ 11) or prospectus (§ 12(a)(2)) contains a material misstatement or omission. (App. 79-86.)

The decision below conflicts with prior decisions of other courts of appeals on three important questions of federal law that significantly impact a purchaser's ability to seek redress under §§ 11 and 12(a)(2) of the 1933 Act. *First*, the Eleventh Circuit dismissed Oxford's §§ 11 and 12(a)(2) claims, which did not involve any allegation of fraud, by applying a heightened pleading standard that required "fact" rather than "notice" pleading. *Second*, the Eleventh Circuit held that Kos's omitted prescription data was "material," but nonetheless immune from mandatory disclosure, thereby abrogating the "full disclosure" standard for issuer liability under §§ 11 and 12(a)(2). *Finally*, the Eleventh Circuit levied sanctions against Oxford and its counsel for failing to plead "facts" in its complaint, despite the novel, erroneous nature of the pleading standard against which the court measured the adequacy of the complaint.

A. The Secondary Offering and the Immediate Collapse of Kos's Stock Price.

Kos is a publicly traded pharmaceutical company. (App. 2.) During the relevant period, Kos had only one product: a prescription cholesterol-management drug called Niaspan. On October 21, 1997, Kos filed an SEC registration statement and prospectus for the Secondary Offering. (App. 3.) Kos set the offering price at $42.75 per share. (*Id.*) As part of the Secondary Offering, Kos and two of its top executives sold 3.65 million shares for nearly $155 million during a four-day period ending October 24, 1997. (*Id.*) Oxford purchased 1000 shares of Kos Stock. (R. 1 ¶ 10.)

On November 12, 1997, just 13 trading days after the close of the Secondary Offering, a Salomon Brothers analyst, Robert Uhl, released a report (the "Uhl Report"), which showed, based on prescription data largely collected (but not disclosed) before the Secondary Offering, that Niaspan was a commercial failure. (App. 3; R.1, ¶ 59.)

Salomon Brothers was one of the Secondary Offering's underwriters.

The previously undisclosed data showed that only 708 Niaspan prescriptions were filled in the first eight weeks of Niaspan sales (a period ending on October 31, 1999); that figure was well below the number of prescriptions needed during that period (5,000) to justify the earnings estimates contained in Kos's prospectus. (*Id.*) According to the Uhl Report, the first eight weeks of prescription data is generally considered to be a reliable indicator of future commercial performance. (App. 3.)

Uhl slashed in half his Kos earnings estimate and changed the rating of the stock from "buy" to "hold." (*Id.*) The market reaction was immediate: the Kos stock plummeted nearly 50% to $16-9/16 on the day the Uhl Report was released. (*Id.*) Thus, within a few days, the market value of the shares sold in the Secondary Offering had declined from $155 million to $60 million—a loss to investors of nearly $100 million.

Following the dramatic collapse of Kos's stock price, Oxford consulted the Susman Firm concerning its loss. A seven-month investigation followed. (R.67, Ex. A, ¶ 3.) The Susman Firm reviewed Kos's SEC filings, its press releases regarding Niaspan, the publicly available facts surrounding the Secondary Offering, and available securities analyst reports. (*Id.* at ¶¶ 4-7.) To evaluate Niaspan itself, the Susman Firm reviewed nine medical studies of the drug and its active ingredient, niacin, and consulted two medical experts experienced in pharmacological studies and the treatment of lipid disorders. (*Id.* at ¶¶ 4-9, 12-13; R.24, Ex. A.) Based on the available data and expert analyses, Oxford's counsel concluded that Oxford had actionable claims against Kos and others under both the 1933 Act and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78(j), 78(t)(a).

B. District Court Proceedings.

On August 10, 1998, Oxford filed a securities class action complaint in the United States District Court for the Northern District of Illinois against Kos, certain of its officers and directors, and the lead underwriters. (App. 5.)[3] The case was later transferred to the Southern District of Florida. Jurisdiction in the district court was based on 28 U.S.C. § 1331 because the case involved a federal question.

Among other statutory and common law claims, Oxford's complaint asserted claims under §§ 11, 12(a)(2), and 15 of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77l(a)(2), and 77(o).[4] The complaint alleged that Kos's offering materials contained material misstatements and omissions regarding the prescription history, efficacy, and safety of Niaspan. It expressly stated that Oxford's 1933 Act claims did not rest on fraud. (R. 1 ¶¶ 66, 77, 85.).

Oxford pleaded that Kos's offering materials contained three specific categories of material misstatements or omissions:

(a) Kos's prospectus omitted material historical prescription data (reflected in the Uhl Report) showing that the level of Niaspan prescriptions could not support the prospectus's earnings estimates;

(b) Kos misrepresented Niaspan's efficacy by falsely stating that Niaspan could boost "good" HDL cholesterol "by up to 32%"; and

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[3] A profit-sharing plan was also a plaintiff in the district court. The plan joined in Oxford's appeal of the sanctions order, but is not a petitioner here. (*See* App. 5.)

[4] Plaintiffs also alleged violations of §§ 10(b) and 20(a) of the 1934 Act, 15 U.S.C. §§ 78(j) and 78(t)(a), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. Those claims are no longer involved in this case.

(c) Kos misstated material information regarding the safety of Niaspan, both by omitting to disclose that Niaspan was intolerable at the effective dose of 2000mg, and by basing safety claims on defective clinical trials that excluded pre-menopausal women, who have lower tolerances to the drug's side effects.

On May 19, 1999, the district court granted defendants' motion to dismiss Oxford's complaint. (App. 6.) The district court held that: (1) Kos's omission of its first eight weeks of prescription data was immaterial as a matter of law, and could not therefore support a claim under §§ 11 and 12(a)(2) (App. 49-53); and (2) Oxford had not pleaded sufficient facts to support its allegations of material misrepresentations regarding the safety, efficacy, tolerability, and sales volume of Niaspan. (App. 42-49.) The district court stated that Oxford's claims were "conclusory" and "factually insufficient," and it dismissed Oxford's complaint with prejudice, holding that "the deficiencies in Plaintiff's claims cannot be cured." (App. 59.)

Defendants thereafter moved for sanctions under the PSLRA and Fed. R. Civ. P. 11. On January 31, 2000, without conducting a hearing, the district court granted defendants' motion and levied sanctions against plaintiffs and their counsel for filing the complaint. (App. 61-73.) The district court found that Oxford's legal arguments were not frivolous, and that Oxford's counsel had conducted an adequate investigation before filing the complaint. (App. 67.) However, the court determined that plaintiffs and their counsel should be sanctioned based on "factual deficiencies" in the complaint: Oxford's "claims were objectively frivolous and counsel for Plaintiffs should have been aware . . . that it was factually deficient." (App. 68.) The court further held that "all of Plaintiff's claims were devoid of evidentiary support," and it ordered that plaintiffs and their counsel pay all of defendants' attorneys

fees and costs (App. 73), which the court later assessed at $502,576.82. (App. 74-76.)[5]

C. Court of Appeals Proceedings.

On appeal, the Eleventh Circuit affirmed both the dismissal with prejudice of Oxford's §§ 11 and 12(a)(2) claims and the half-million dollar sanction which the district court levied against Oxford and its counsel. First, the Eleventh Circuit articulated an unusual standard for determining an issuer's liability under §§ 11 and 12(a)(2). The court specifically acknowledged that the withheld prescription data was "material," but nonetheless held that Kos had no duty to disclose it. (App. 11-16.) Contrary to the law of other circuits, the Eleventh Circuit held that § 11 does not create a general duty to disclose all known material factual information. According to the court, "requir[ing] *all* material information to appear in the prospectus would . . . result in registrants burying the shareholders in an avalanche of trivial information." (App. 12 (emphasis original).) The court further stated that Kos had no duty to disclose the prescription data because the prospectus was not misleading. (App. 16.)

Second, the Eleventh Circuit accepted Kos's contention that the sufficiency of Oxford's complaint should be determined under a "fact pleading" standard. (App. 16-20.) Thus, the court of appeals upheld the dismissal of each of Oxford's claims regarding the safety and efficacy of Niaspan on the ground that the complaint contained insufficiently particularized factual detail. (*Id.*) As to the efficacy claim, the Eleventh Circuit held that Oxford failed "to allege facts

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[5] The district court subsequently raised the sanction to $520,091.82, ordering plaintiffs' counsel to pay $260,045.91, with plaintiffs paying the remainder.

that support the conclusion that the 32% [increase in HDL cholesterol] claim is false." (App. 17.) Similarly, the safety claim was deemed factually insufficient because (a) Oxford "does not plead the existence of facts that would support its allegation that Niaspan elevates liver enzymes to an intolerable level [and] [n]o studies are referred to, no specific facts are pleaded that indicate any basis for Oxford's bald assertions," and (b) Oxford's complaint "fails to plead any factual basis" for its claim that the Prospectus was based on "skewed" clinical trials. (App. 18-19.) The Eleventh Circuit did not identify the source of the heightened pleading standard it applied, and gave no explanation for choosing it.

Third, the Eleventh Circuit substantially affirmed the district court's decision to sanction Oxford and its counsel for filing the complaint. (App. 20-26.) The Eleventh Circuit vacated the order and remanded for further proceedings, holding that the sanctions award should be reduced slightly because Kos was not entitled to fees with respect to Oxford's claim based on omission of the prescription data. (App. 26.) However, the Eleventh Circuit upheld the rest of the sanctions award, holding that the district court did not abuse its discretion in concluding that Oxford's other claims, all dismissed at the motion stage, "lack[ed] evidentiary support." (App. 22.)

A timely petition for rehearing *en banc* was denied on March 25, 2003. (App. 77-78.)

REASONS FOR GRANTING THE PETITION

In holding that Oxford's §§ 11 and 12(a)(2) claims should be dismissed for failure to plead specific supporting facts—and then affirming a half-million dollar sanction against Oxford and its lawyers for failing to meet that heightened pleading standard—the Eleventh Circuit

decided fundamental questions of federal securities law, arising in virtually every securities action brought under those sections. The Eleventh Circuit did so in a way that imposes substantial additional burdens on those who would enforce the securities laws. The decision below also conflicts with decisions of other circuits concerning both the pleading standard for §§ 11 and 12(a)(2) claims and the substantive rules for determining an issuer's liability under those sections, as well as with bedrock principles of federal pleading law previously established by this Court. Similarly, the imposition of a half-million dollar sanction in this case is unprecedented, departs from the ordinary course of judicial proceedings, and is manifestly unjust. The decision below clearly warrants review by this Court.

1. The Eleventh Circuit's unambiguous, albeit unexplained, application of a heightened "fact pleading" standard to Oxford's §11 and §12(a)(2) claims conflicts with decisions of several courts of appeals. *First*, the decision below is consistent with decisions in the Third and Ninth Circuits, but conflicts with decisions of the Eighth and Fifth Circuits, which specifically hold that plaintiffs bringing § 11 and § 12(a)(2) claims in similar circumstances need only meet the "notice pleading" standard of Fed. R. Civ. P. 8(a). In *In re NationsMart Corp. Securities Litigation*, 130 F.3d 309, 314 (8th Cir. 1997), the Eighth Circuit specifically held that § 11 and § 12(a)(2) claims need not satisfy the Fed. R. Civ. P. 9(b) particularity requirement for pleading fraud under *any* circumstances because fraud is not an element of those actions. Similarly, in *Lone Star Ladies Investment Club v. Schlotzsky's Inc.*, 238 F.3d 363, 369 (5th Cir. 2001), the Fifth Circuit held that the Rule 8 standard applies if, as here, the plaintiff's § 11 and § 12(a)(2) claims expressly disclaim any reliance on fraud. *Second*, to whatever extent the Eleventh Circuit may have thought that a heightened

pleading standard was required by the PSLRA, the decision below is not only contrary to the plain language of that statute, but is also inconsistent with the Eighth Circuit's decision in *Romine v. Acxiom Corp.*, 296 F.3d 701, 704-05 (8th Cir. 2002), which held that the PSLRA pleading standard does not apply to §§ 11 and 12(a)(2) claims. *Finally*, the Eleventh Circuit's decision, which imposes a pleading standard more arduous than that mandated by Congress, exceeds the power of the judicial branch, as this Court has held in other circumstances. *See, e.g.*, *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993) (a requirement of greater specificity for particular claims "is a result that must be obtained by the process of amending the Federal Rules, and not by judicial interpretation").

2. The Eleventh Circuit's decision warrants review for a second reason. By holding that §§ 11 and 12(a)(2) do not require the disclosure of all material information in securities offering documents, the Eleventh Circuit decided an important question of law, which is central to the proper enforcement of the securities laws, in a way that is erroneous and conflicts directly with the law of the Second Circuit. To hold, as the Eleventh Circuit did, that information may be material, but nonetheless, not subject to mandatory disclosure, is a logical impossibility. Under §§ 11 and 12(a)(2), as the Second Circuit has held, *all* material information must be disclosed; an issuer's liability for withholding material information is "absolute." *Kronfeld v. Trans World Airlines, Inc.*, 832 F.2d 726, 730 n.8 (2d Cir. 1987), *citing Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983).

3. The decision below also warrants review with respect to the half-million dollar sanction that was levied against Oxford and its counsel. In this case, the court of appeals applied a new pleading standard for §§ 11 and 12(a)(2)

claims in the Eleventh Circuit. That standard is both contrary to the law of other circuits and wrong. A party cannot be sanctioned for failing to comply with an erroneous legal standard. Moreover, even if the standard were not itself erroneous, at least one other circuit has held that sanctions cannot be imposed where the law is unsettled. As the Seventh Circuit held in *Hartmarx Corp. v. Abboud*, 326 F.3d 862, 868 (7th Cir. 2003), a party cannot be sanctioned for guessing wrong on how a particular court will decide an unsettled question of law. For a half-million dollar sanction to be assessed against a party and its attorneys in such circumstances so far departs from the normal course of judicial proceedings as to warrant review for that reason alone.

I. Whether A "Fact Pleading" Standard Should Be Applied To § 11 and § 12(a)(2) Claims Is An Important Question of Federal Law Upon Which The Courts of Appeals Are Divided.

Although fraud is not an element of a § 11 or § 12(a)(2) claim, the courts of appeals are deeply divided on whether a heightened pleading standard applies to such claims. Five circuits have now addressed the issue. The Eighth Circuit has correctly determined that such claims need meet only the "notice pleading" standard of Fed. R. Civ. P. 8(a). The Third and Ninth Circuits have held that the heightened Fed. R. Civ. P. 9(b) standard—which requires that allegations of fraud be pleaded with factual particularity—applies when the claim "sounds in fraud." The Fifth Circuit has held that § 11 claims should be evaulated under the Rule 8 standard if the claimant disavows that its claim is based on fraud. The decision below, which applies a heightened "fact pleading" standard to Oxford's § 11 and § 12(a)(2) claims, notwithstanding Oxford's expressed disavowal of any fraud-based theory, adds further confusion to this division, which warrants resolution by this Court.

1. Absent a federal procedural rule or statutory provision, complaints in federal court need only meet the "notice pleading" requirement of Fed. R. Civ. P. 8(a); that is, the complaint need contain only a "short and plain statement of the claim showing that the pleader is entitled to relief." *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993). The purpose of a complaint in the federal system is to "give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests." *Conley v. Gibson,* 355 U.S. 41, 47 (1957). "[T]he Federal Rules of Civil Procedure *do not require a claimant to set out in detail the facts on which he bases his claim.*" *Id.* (emphasis added). Consequently, "[a] complaint that complies with the Rules of Civil Procedure cannot be dismissed on the ground that it is conclusory or fails to allege facts." *Higgs v. Carver*, 286 F.3d 437, 439 (7th Cir. 2002).

In this case, the Eleventh Circuit clearly demanded a level of factual specificity beyond the established requirements of notice pleading. *See Annual Review of Federal Securities Litigation*, 58 Business Lawyer 747, 869-73 (2003) (criticizing the heightened pleading standard applied by the Eleventh Circuit in this case). The Eleventh Circuit affirmed dismissal of Oxford's claim regarding Niaspan's effectiveness "for failure to allege facts that support the conclusion." (App. 17.) The court of appeals affirmed dismissal of Oxford's claims regarding Niaspan's safety, holding that "[n]o studies are referred to, no specific facts are pleaded that indicate any basis for Oxford's bald assertions." (App. 18.) The court of appeals also held that "Oxford's complaint fails to plead any factual basis" for its allegation that clinical trials of Niaspan skewed safety data, and further held that "the complaint does not allege any facts that support the conclusion" that the prospectus misstated sales figures. (App. 19.) In sum, the Eleventh

Circuit expressly required Oxford to plead particularized facts to support its §§ 11 and 12(a)(2) claims (App. 16-20), and it affirmed dismissal of those claims for failure to meet that heightened standard. (*Id.*)

Although the circuits are divided on the proper pleading standard for §§ 11 and 12(a)(2) claims, neither Rule 9(b), the PSLRA, nor any other possible exception to Rule 8(a) provides any basis for imposing a heightened pleading standard for such claims.

2. The Eleventh Circuit's unambiguous application of a heightened "fact pleading" standard conflicts with prior decisions of the Eighth and Fifth Circuits. In *In re NationsMart Corp. Securities Litigation*, 130 F.3d 309 (8th Cir. 1997), plaintiffs alleged that NationsMart's prospectus failed to disclose material facts regarding a downtrend in business and an increase in operating costs. *Id.* at 314. Applying a heightened pleading standard, the district court dismissed plaintiffs' complaint with prejudice for failure to plead facts with sufficient particularity. *Id.* The Eighth Circuit reversed, holding that § 11 and § 12(a)(2) claims need meet only the notice pleading standard of Rule 8(a). *Id.* at 315-16.

The Eighth Circuit acknowledged a division of authority as to whether § 11 and § 12(a)(2) claims must meet the particularity requirements of Rule 9(b), noting that some circuits have held that such claims must meet the Rule 9(b) requirement if they "sound in fraud" rather than negligence. *See id.* at 315, *citing In re Stac Elec. Sec. Litig.*, 89 F.3d 1399, 1404-05 n.2 (9th Cir. 1996), *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 288 (3d Cir. 1992), *Melder v. Morris*, 27 F.3d 1097, 1100 n.6 (5th Cir. 1994). However, the Eighth Circuit specifically rejected the "sounds in fraud" theory, holding that the heightened "fact pleading" standard is not applicable in §§ 11 and 12(a)(2) claims be-

cause fraud is not an element in such actions. *Id.* at 315. The Eighth Circuit held that "a pleading standard which requires a party to plead particular facts to support a cause of action that does not include fraud or mistake as an element comports neither with Supreme Court precedent nor with the liberal system of 'notice pleading' embodied in the Federal Rules of Civil Procedure." *Id.*[6]

While the Eighth Circuit held in *NationsMart* that § 11 and § 12(a)(2) claims are *never* subject to the Rule 9(b) pleading standard, the Fifth Circuit has staked out an intermediate position, holding that § 11 claims should be evaluated under the Rule 8 "notice pleading" standard if, as here, the claimant disavows that its claim is based on fraud. *See Lone Star Ladies Inv. Club v. Schlotzsky's Inc.*, 238 F.3d 363, 369 (5th Cir. 2001). The Fifth Circuit held in *Lone Star* that where a plaintiff's claim under § 11 "expressly do[es] not assert that defendants are liable for fraudulent or intentional conduct and disavow[s] and

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[6] In those circuits that have not yet decided the question, district courts are also divided over the proper pleading standard for §§ 11 and 12(a)(2) claims. Some district courts in other circuits have followed the *NationsMart* approach. *See, e.g., In re Initial Pub. Offering Sec. Litig.*, 241 F.Supp.2d 281, 338-39 (S.D.N.Y. 2003) ("Because there is no need to prove fraud in a § 11 claim, there is no need to satisfy Rule 9(b). Because a plaintiff cannot be required to *plead* something it need not *prove*, I join the majority of courts in this district that have concluded that Rule 9(b) does not apply to § 11 claims.") (emphasis original); *accord In re First Merchs. Acceptance Corp. Sec. Litig.*, No. 97 C 2715, 1998 WL 781118, *11-12 (N.D. Ill. Nov. 4, 1998). Other district courts have followed the "sounds in fraud" approach. *See, e.g., Krieger v. Gast*, No. 4:99-CV-86, 2000 WL 288442, *6 (W.D. Mich. Jan 21, 2000) ("where fraud is alleged, the claim should be tested under Rule 9(b)'s requirements even if the claim may be established without proof of fraud").

disclaim[s] any allegation of fraud . . .[t]hose claims do not 'sound in fraud' and cannot be dismissed for failure to satisfy Rule 9(b)." *Id.*

The Eleventh Circuit's use of a heightened pleading standard—despite Oxford's disclaimer of any reliance on fraud in its § 11 and § 12(a)(2) claims—cannot be reconciled with the decisions of the Fifth and Eighth Circuits. As shown above, the Fifth and Eighth Circuits are themselves in conflict on the precise pleading standard to be applied, but the decisions of both those circuits conflict with the Ninth Circuit's decision in *In re Stac Elec. Sec. Litig.*, the Third Circuit's decision in *Shapiro*, and the Eleventh Circuit's decision in this case. Uniformity in the application of the federal securities laws requires that this Court review the decision below.

3. To the extent that the Eleventh Circuit may have derived its "fact pleading" standard for § 11 claims from the PSLRA, its decision is contrary to the language of that statute, which creates a heightened pleading standard for claims under the 1934 Act, but not for 1933 Act claims, such as those presented here. The PSLRA added § 21D to the 1934 Act. That section requires a claim under § 10(b) of the 1934 Act to specify each misleading statement, the reason why the statement is misleading, and particular facts "giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(1)-(2). Although the PSLRA expressly created a heightened pleading standard for 1934 Act claims, it did not change the pleading standard for 1933 Act claims, such as those brought under §§ 11 and 12(a)(2). *Compare* 15 U.S.C. § 77z-1, *with* 15 U.S.C. § 78u-4. The PSLRA added § 27 to the Securities Act of 1933. That section parallels the provisions of § 21D in many ways, and provides substantially identical procedural changes. However, § 27 of the 1933 Act—unlike § 21D of the 1934 Act—specifically omits

a parallel heightened pleading standard for § 11 and § 12(a)(2) claims. 15 U.S.C. § 77z-1.

The Eleventh Circuit's decision also conflicts with the Eighth Circuit's holding that the PSLRA's heightened pleading standard is inapplicable to § 11 claims. In *Romine v. Acxiom Corp.*, 296 F.3d 701, 704 (8th Cir. 2002), the Eighth Circuit noted that the heightened PSLRA pleading standard does not apply to claims brought under the 1933 Act. The *Romine* court held that the PSLRA left the Rule 8(a) pleading standard for § 11 claims intact: "[t]he structure and legislative history of that Act persuade us that § 78u-4 applies only to fraud actions brought under the Securities Exchange Act of 1934 . . . [a]ccordingly, *NationsMart* remains a controlling precedent, and plaintiffs' complaint need only comply with the short and plain statement requirements of Rule 8(a)." *Romine*, 296 F.3d at 704-05; *see also Falkowski v. Imation Corp.*, 309 F.3d 1123, 1133 (9th Cir. 2002).

4. Finally, as this Court has previously held, the federal courts do not have a roving commission to impose pleading requirements more demanding than those established by Congress: a requirement of greater specificity for particular claims "is a result that must be obtained by the process of amending the Federal Rules, and not by judicial interpretation." *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993); *accord Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 512-13 (2002).

It is clear that the heightened pleading requirement imposed by the court below is improper. Because of the conflict among the circuits on this important question of federal law, review by this Court is necessary.

II. Whether, As A Matter Of Law, Material Facts May Be Withheld From Disclosure In A Prospectus Without Leading To Liability Under §§ 11 and 12(a)(2) Is An Important Question Of Federal Law Upon Which The Courts Of Appeals Are Divided.

The Eleventh Circuit's determination that Kos should be deemed not liable as a matter of law under §§ 11 and 12(a)(2), despite its omission of material prescription data from its prospectus, conflicts with the Second Circuit's decision in *Kronfeld v. Trans World Airlines, Inc.*, 832 F.2d 726 (2d Cir. 1987). In *Kronfeld*, the court recognized that material facts must be disclosed in offering materials, and that a finding of materiality ends the inquiry and necessarily subjects the non-disclosing issuer to strict liability.

The Eleventh Circuit effectively amended the disclosure requirements of § 11, dismissing Oxford's complaint despite finding that Kos's prospectus omitted material data regarding the first eight weeks of Niaspan prescriptions. (App. 11-16.) In so holding, the Eleventh Circuit stated that "[w]e join with the First Circuit in recognizing that the 'mere possession of material nonpublic information does not create a duty to disclose it.'" (App. at 12, *citing Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1202 (1st Cir. 1996).) The Eleventh Circuit stated that "to require *all* material information to appear in the prospectus would, like setting the threshold for materiality too low, result in registrants burying the shareholders in an avalanche of trivial information." (*Id.*) In other words, the Eleventh Circuit held that the omitted prescription data was "material" for purposes of its "materiality" analysis, but not sufficiently important to warrant disclosure. The court made this determination, of course, in the context of a

motion to dismiss.[7]

In *Kronfeld*, the Second Circuit recognized that such a paradoxical conclusion is inconsistent with the simple strict liability standard which the statute establishes for §§ 11 and 12(a)(2) claims. The district court in *Kronfeld* disposed of plaintiff's § 11 claim on summary judgment, holding that the defendant had no duty to disclose the omitted information concerning a prospective corporate restructuring. The Second Circuit reversed. In doing so, the court of appeals noted that the district court's decision "might be taken to mean that the district court followed a two-step analysis under Section 11 of the Act—one focusing first upon duty to disclose and thereafter on materiality. . . . [That approach] finds no support in the language of Section 11 of the 1933 Act, or in the few cases which have interpreted it." *Kronfeld*, 832 F.2d at 730 n.8.[8] The Second Circuit also found the two-step analysis for an issuer's liability inconsistent with this Court's decision in *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382

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[7] The Eleventh Circuit interpreted the First Circuit's ruling as requiring a two-step liability analysis: (1) asking whether the omitted data was material, and (2) separately analyzing whether the issuer had a duty under §§ 11 and 12(a)(2) to disclose the omitted data. (App. 9, 11-12.) As for the first step, the Eleventh Circuit disagreed with the district court's conclusion and assumed that the prescription data was material. (App. 11.) However, the Eleventh Circuit found that Kos nevertheless had no duty under §§ 11 or 12(a)(2) to disclose that material information. (App. 11-16.)

[8] The *Kronfeld* court gave the district court the benefit of the doubt, concluding that the district court must have meant to hold that the undisclosed information was immaterial as a matter of law. *Kronfeld*, 832 F.2d at 730 n.8. Such an inference is not possible here, where the Eleventh Circuit expressly assumed that the omitted prescription data was material.

(1983), in which this Court held that a plaintiff "need only show a material misstatement or omission to establish [a] *prima facie* case" for a § 11 violation, and that "liability against the issuer of a security is virtually absolute, even for innocent misstatements." 459 U.S. at 382 (holding that "Section 11 places a relatively minimal burden on a plaintiff.")[9]

In *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259 (2d Cir. 1993), the Second Circuit subsequently confirmed that there is no need, even under the arguably less stringent disclosure standard for § 10(b) claims, to analyze separately whether there was a duty to disclose, when the omission of an existing fact would render a prior statement misleading. The *Time Warner* court noted that: "[i]f a reasonable investor would . . . regard the omitted fact [as material], it is difficult to imagine a circumstance where the prior statement would not be rendered misleading in the absence of the disclosure." *Id* at 268.

The Second Circuit's view is undoubtedly correct. If a fact is material to a securities offering it must be disclosed. To be material, and yet not subject to disclosure, is a logical impossibility under §§ 11 and 12(a)(2). In that sense, the Second Circuit's view is consistent with this Court's recognition that the 1933 Act "was designed to provide investors with *full disclosure of material information* concerning public offerings of securities in commerce." *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 195 (1976) (emphasis added). This purpose of full disclosure is also manifest in this Court's adoption of a strict liability standard for §§ 11 and 12(a)(2) claims, and in its holding that a claimant under those sections need only plead a mate-

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[9] Section 12 has a similar "strict liability" standard. *Printer v. Dahl*, 486 U.S. 622, 638 (1988).

rial misstatement or omission of fact to shift the burden of proof to the issuer. *Herman & MacLean*, 459 U.S. at 382.

The Eleventh Circuit's contrary decision cannot be reconciled with the decisions of the Second Circuit, the absolute liability standard established by this Court, or this Court's holding that a claimant need only show a material misstatement or omission to make out a *prima facie* case under §§ 11 and 12(a)(2). Review of the Eleventh Circuit's decision is therefore warranted in this case.

III. The Eleventh Circuit's Decision To Affirm A Half-Million Dollar Sanction Against Oxford And Its Counsel Is Manifestly Erroneous, Departs From The Ordinary Course Of Judicial Proceedings, And Conflicts With A Contrary Decision Of The Seventh Circuit.

The Eleventh Circuit upheld a half-million dollar sanction against Oxford and its counsel for failing to meet the "fact pleading" standard it applied for the first time in this case. As we have shown (*see* pages 11-16, *supra*), the Eleventh Circuit standard is erroneous and cannot therefore support the granting of sanctions. *See Hartmarx Corp. v. Abboud*, 326 F.3d 862, 867 (7th Cir. 2003) *quoting Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 405 (1990) ("[a] district court would necessarily abuse its discretion if it based its ruling on an erroneous view of the law"). At all events, the law relating to the proper pleading standard was at best an unsettled question in the Eleventh Circuit prior to the decision below, and it was also the subject of a split among the circuits. The Eleventh Circuit sanctioned Oxford for guessing wrong on how that unresolved question would be decided.

In *Hartmarx*, the Seventh Circuit correctly rejected the view that parties may be sanctioned for guessing wrong

on an unresolved question of law. *Hartmarx*, 326 F.3d at 868. The district court in *Hartmarx* imposed sanctions under the PSLRA and Rule 11 against defendants for fees incurred in litigating certain misstatements concerning the financing of a proposed tender offer. *Id.* at 866. The Seventh Circuit reversed the sanctions award, emphasizing that the scope of a defendant's duty to disclose its financing arrangements was not clear. The *Hartmarx* court held that "[t]he debate between the parties involves a close question of law under this new regime. As such, as long as [defendant] was taking a reasonable legal position on the meaning of the rule, it should not be sanctioned even if the district court concluded that [plaintiff] had the better reading." *Id.*; *accord CJC Holdings, Inc. v. Wright & Lato, Inc.*, 989 F.2d 791, 794 (5th Cir. 1993) ("a trial court should not impose Rule 11 sanctions for advocacy of a plausible legal theory, particularly where, as here, the law is arguably unclear.").

Here, in light of the decisions in *NationsMart* and *Lone Star Ladies*—and the Eleventh Circuit's previous silence on the issue—Oxford's attorneys acted reasonably in thinking that Oxford was required to include only "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a). However, the Eleventh Circuit affirmed the district court's decision to impose a half-million dollar sanction against Oxford and its counsel for wrongly predicting the future course of Eleventh Circuit law. As the Seventh Circuit has recognized, the impact of such a draconian decision extends far beyond the particular party involved: "[i]n exercising its discretion, a district court must also bear in mind that such sanctions are to be imposed sparingly, as they 'can have a significant impact beyond the merits of the individual case' and can affect the reputation and creativity of counsel." *Hartmarx*, 326 F.3d at 867.

The decision approving sanctions in this case is without support, and it so far departs from the ordinary course of judicial proceedings as to warrant review for that reason alone.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: June 23, 2003